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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS
JEFF HATCH-MILLER - Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

Arizona Corporation Commission
DOCKETED
JUN - 1 2005
DOCKETED BY

IN THE MATTER OF THE APPLICATION OF LAS QUINTAS SERENAS WATER COMPANY FOR AN OPINION AND ORDER TO (I) RE-OPEN THE RECORD IN THE RECENT RATE CASE SO AS TO CONSIDER EVIDENCE IN SUPPORT OF AN ARSENIC COST RECOVERY MECHANISM, AND (II) MODIFY RATE CASE DECISION IN ORDER TO ADD AN ARSENCI COST RECOVERY MECHANISM AS AN AUTHORIZED RATE SURCHARGE

DOCKET NO. W-01583A-05-0340

NOTICE OF FILING STAFF'S RESPONSE TO APPLICANT'S REQUEST TO RE-OPEN THE RECENT RATE PROCEEDING IN DOCKET NO. W-01583A-04-0178

Arizona Corporation Commission Staff ("Staff") notices that it has filed a response to the Las Quintas Serenas ("LQS") motion to re-open Decision No. 67455 in Docket No. W-01583A-04-0178 – LQS' most recent rate case. As explained in its response attached to this pleading, Staff is not opposed to re-opening the rate case solely for the purpose of determining whether an Arsenic Cost Recovery Mechanism ("ACRM") is appropriate. Staff understands this docket to just be dealing with the issue of arsenic treatment and an ACRM. So, Staff is not opposed to this docket. But Staff is opposed to re-opening the rate case for any reason other than exploring the arsenic treatment issue. This is why Staff has requested that Docket No. W-01583A-05-0339 should be administratively closed.

RESPECTFULLY SUBMITTED this 1st day of June, 2005.

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LEGAL DIV.
ARIZ. CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF LAS QUINTAS SERENAS WATER COMPANY FOR AN INCREASE IN ITS WATER RATES FOR CUSTOMERS WITHIN PIMA COUNTY, ARIZONA	DOCKET NO. W-01583A-04-0178 **STAFF RESPONSE**

Staff of the Arizona Corporation Commission ("Staff") responds to the motion to reopen proceeding from Las Quintas Serenas Water Company ("LQS" or "Company") as follows:

BACKGROUND

LQS has made four separate filings, but those filings are all inter-related. First, LQS made a financing application to incur up to $1,789,375 in long-term debt in order to make capital improvements to address the new arsenic standards and to make other water system improvements. This application is now Docket No. W-01583A-05-0326. Second, LQS filed a new application to re-open the record in its most recent rate case, Docket No. W-01583A-04-0178, to amend Decision No. 67455 so that the debt financing could be included in present rates for capital improvements not related to arsenic treatment. This application is now Docket No. W-01583A-05-0339. Third, LQS made a new application to amend Decision No. 67455 so that the arsenic treatment costs related to the debt financing could be recovered through an Arsenic Cost Recovery Mechanism ("ACRM"). This application is now Docket No. W-01583A-05-0340. Fourth and finally, LQS motioned to reopen the rate case in Docket No. W-01583A-04-0178. It is this motion that Staff's response focuses on, although copies of this response will be filed in all of the relevant dockets[1]. Staff believes the applications in Docket Nos. W-01583A-05-0339 and -0340 are basically different means to achieve the end result of re-opening the rate case in Docket No. W-01583A-04-0178. As argued below, while Staff does not oppose the request to re-open the rate case docket for the sole purpose to

[1] Staff will be requesting to administratively close Docket No. W-01583A-05-0339.

address arsenic costs and recovery, Staff does oppose re-opening the rate case docket for any other reason.

Staff believes that the reason behind LQS' many filings is based on actions it has taken since the final decision in the recent rate proceeding. It appears that LQS requested the aid of an outside consultant to address the arsenic treatment issue. That consultant, Westland Resources, Inc., presented LQS with a plan to deal with the arsenic problem in its wells outlined in Finding of Fact No. 42. That plan, however, also recommends additional capital improvements not related to solving the arsenic problem. See LQS' Application in Docket No. W-01583A-05-0339 at 2-3, and LQS' Application in Docket No. W-01583A-05-0340 at FN 2. The total amount of capital costs incurred if Westland's plan is adopted would be $1,789,375, which is the exact amount that LQS is requesting financing approval for in Docket No. W-01583A-05-0326. But only $995,625 of the total amount requested in that financing application is to address arsenic.

THE LEGAL STANDARD TO REVISIT A COMMISSION DECISION

Staff agrees with LQS that A.R.S. § 40-252 governs requests to amend or modify a Commission Decision. That statute gives the Commission the authority, after notice and opportunity to be heard, to "rescind, alter or amend any order or decision made by it." This power the Commission has, even though Decision No. 67455 is a final decision no longer subject to an appeal or which can be collaterally attacked, also per A.R.S. § 40-252. The Commission is under no obligation to re-open LQS' rate proceeding, although it has the discretion to do so.

Staff's qualm with LQS is not whether the Commission can re-open the rate proceeding or whether it can amend Decision No. 67455 in a subsequent decision. Rather, Staff's issues are:

1. Whether Decision No. 67455 should be revisited and the rate case re-opened.
2. What should be the scope of any re-visitation of LQS' rate proceeding recently decided.

Staff's response to those two issues is that Decision No. 67455 should only be revisited for purposes of determining whether an ACRM is appropriate – for LQS – for costs regarding arsenic treatment and that the scope of re-opening LQS' recent rate proceeding should be limited to dealing only with the issues of arsenic treatment and cost recovery for that treatment.

Implicated in this analysis is Scates v. Arizona Corporation Commission, 118 Ariz. 531, 578

P.2d 612 (1978). Scates holds that the Commission has broad discretion in establishing rates, so long as a reasonable rate of return is granted. 118 Ariz. at 534, 578 P.2d at 615. But fair value must also be considered when establishing rates. Id. quoting Simms v. Round Valley Light & Power Co., 80 Ariz. 145, 151, 294 P.2d 378, 382 (1956). It is possible that the Commission could include LQS' capital improvement costs into base rates, but that would involve making a new fair value determination from scratch. Expenses, such as depreciation, and the revenue requirement would also likely be affected. In other words, we would essentially be faced with a whole new rate case.

To deal with the arsenic problem, the concept of a cost-recovery mechanism, the ACRM, has been introduced in limited situations. The ACRM approved in prior cases is only a pass-through mechanism. In other words, a company given an ACRM would not be getting a return on any costs or expenses related to arsenic treatment. Hence, the fair value and rate of return previously approved in a recent rate case – within six months – would not be affected. Even so, a cost recovery mechanism like the ACRM should only to be put in place when extraordinary circumstances warrant such treatment. Arsenic treatment is an extraordinary circumstance. Non-arsenic related capital improvements that LQS is proposing for recovery are not extraordinary and a cost recovery mechanism, or any other treatment for those improvements, is inappropriate.

ARGUMENT

Arsenic is one of the most pressing issues affecting water utilities today. The mandate put forth by the Environmental Protection Agency ("EPA") is rapidly approaching, and almost all water utilities are struggling with how to meet the EPA's standard by January 23, 2006. LQS is no exception.

LQS was just granted new rates on January 4, 2005, in Decision No. 67455. This decision was reached only after the Commission carefully considered evidence on the record in pre-filed testimony and during the evidentiary hearing that took place October 13, 2004. Determining just and reasonable rates is often the result of a delicate and meticulous balancing of all the pertinent interests, even though the Commission has considerable discretion in determining what is "just and reasonable." Thus, any effort to re-open a final rate determination should not be considered lightly.

While not a legal standard per se, Staff believes that any re-opening of a rate proceeding

should only be done when extraordinary circumstances warrant that action. Many technical principles, like the test-year utilized and matching proposed expenses to revenues, are affected when a utility proposes to include additional costs into present rates after a decision has been rendered. To put it another way, including additional costs that were outside the test-year for "capital improvements" not yet used and useful will likely lead to re-litigating the entire rate case, only with a stale test year.

So, Staff does not oppose re-opening the rate proceeding for the limited purpose of determining an appropriate mechanism for recovery of costs strictly associated with arsenic treatment only because the arsenic issue is an extraordinary circumstance. Even so, Staff would not recommend that LQS receive any return on capital costs for arsenic treatment and would only recommend a pass-through mechanism, such as the ACRM. This is essentially what LQS has requested for arsenic treatment both in its motion and in its filing of an application under Docket No. W-01583A-05-0340. Staff understands that LQS, as well as many water companies, are subject to regulations from the EPA to lower the concentration of arsenic in drinking water to 10 parts per billion by January 23, 2006. Furthermore, Staff agrees that the findings in Decision No. 67455 regarding arsenic were preliminary estimates only. Precedent has been established for re-opening rate proceedings recently concluded to determine the appropriate treatment for the extraordinary circumstances of dealing with the rapidly impending deadline of the new EPA arsenic standards and Staff would not oppose such a limited re-opening here. But Staff does not stipulate at this time to the reasonableness of the $995,625 price tag alleged in LQS' application for arsenic treatment, nor does it stipulate to any particulars of any arsenic recovery mechanism here.

The situation cited above is radically different than the LQS' additional proposal to re-open the rate proceeding with regards to getting rate recovery for non-arsenic related capital improvements. Essentially, LQS is requesting recovery in rates for other capital improvements that have not been made and that do not have anything to do with arsenic recovery. This is the substance of LQS' application in Docket No. W-01583A-05-0339. No extraordinary circumstances exist to justify recovery for non-arsenic costs. So, Staff does not believe it is appropriate to re-open a recent rate decision for proposed capital improvements not related to arsenic that have not been built yet.

Typically, recovery for any capital improvements made by a water company would only be allowed when such improvements are presently serving customers. In other words, the Company should be filing a new rate case for recovery of those items after they are in operation. While Staff recognizes the extraordinary circumstances for arsenic, such compelling circumstances are lacking for LQS' non-arsenic-related proposals. Furthermore, to do what LQS is requesting in Docket No. W-01583A-05-0339 would basically involve re-litigating several key components of the rate case with a stale test year, without any compelling reason to do so. LQS is certainly free to file a new rate case with an updated test year and request treatment of these non-arsenic-related capital improvement costs, but Staff does not believe that LQS has given any reason to compel re-opening Decision No. 67455 for anything that is non-arsenic related.

THE FINANCING DOCKET

Also intertwined with the motion to re-open and the two new applications cited above is LQS' application for financing approval in Docket No. W-01583A-05-0326 of $1,789,375. LQS intends to get a loan of that amount from the Water Infrastructure Financing Authority ("WIFA") and/or other lenders. This amount of financing is apparently so that the company will have funding to make capital improvements so that LQS will be in compliance with the new arsenic standards, as well as making additional improvements that have nothing to do with the arsenic issue. It appears that LQS is proposing that $995,625 of the total financing would be for arsenic, and the remainder - $793,750 – would not be for arsenic treatment.

LQS is free to pursue that entire amount in its financing application, but it is likely that Staff's recommendation of the amount requested not related to arsenic will depend on whether the rates approved in Decision No. 67455 allow the Company to adequately pay the interest and pay off the actual amount borrowed. In other words, given that Staff does not support re-opening the recently decided rate case for any other reason other than for arsenic, Staff's analysis of the portion of financing that is not related to arsenic treatment will not include analysis of any future rates, unless directed otherwise. Staff makes no guarantees at this time that it will recommend approval of any amount of financing until its analysis is complete.

...

CONCLUSION

In summary:

1. Staff does not oppose re-opening Decision No. 67455 only for purposes of determining:
   a. Whether an ACRM is appropriate and how that mechanism should be structured.
   b. The amount to be recovered in an ACRM.
2. Staff opposes re-opening Decision No. 67455 for addressing recovery for any capital improvement costs not related to arsenic treatment.
3. Staff's analysis of the financing docket will include and involve whether the rates approved in Decision No. 67455 can adequately cover debt and interest for that portion of the request that is not for arsenic treatment.

Extraordinary circumstances exist to address cost recovery for capital improvements for arsenic treatment. But cost recovery for arsenic should not include any return for those capital improvements. Re-opening Docket No. W-01583A-04-0178 to address cost recovery for capital improvements not related to arsenic is inappropriate because no extraordinary circumstances exist.

RESPECTFULLY SUBMITTED this 23rd day of May, 2005.

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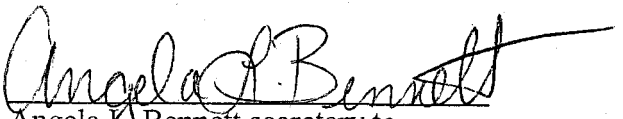

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